PRESENT LAW AND BACKGROUND RELATING TO TAXATION OF CAPITAL GAINS

Scheduled for a Public Hearing

Before the

HOUSE COMMITTEE ON WAYS AND MEANS

on February 12, 1998

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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JCX-4-98

CONTENTS

INTRODUCTION

The House Committee on Ways and Means has scheduled a public hearing on issues relating to capital gains on February 12, 1998. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a discussion of present law, legislative history, and analysis of issues related to the Federal income taxation of capital gains.

Part I of the document is a description of present law and legislative history on capital gains. Part II is an analysis of issues. Appendix A and B, respectively, present copies of IRS capital gains forms (Schedule D for Form 1040) for 1996 and 1997.

[1] This document may be cited as follows: Joint Committee on Taxation, *Present Law and Background Relating to Taxation of Capital Gains* (JCX-4-98), February 6, 1998.

I. PRESENT LAW AND LEGISLATIVE HISTORY

A. Present Law

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of capital assets, any gain generally is included in income, and the net capital gain of an individual[2] is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances that would have been available under the straight-line method of depreciation.

The maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. In addition, any adjusted net capital gain which otherwise would be taxed at a 15-percent rate is taxed at a 10-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax.

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain.[3] The net capital gain is reduced by the amount of gain which the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the amount of net gain attributable to long-term capital gains and losses from property held more than one year but not more than 18 months, gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) held more than 18 months ("collectibles gain and loss"), an amount of gain equal to the amount of gain excluded from gross income under section 1202,

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[2] For purposes of this discussion, an individual includes a trust or estate.

[3] The description of present law includes the technical corrections provisions of Title VI (section 605(d)) of H.R. 2676, the "Tax Technical Corrections Act of 1997," as passed by the House on November 5, 1997.

relating to certain small business stock ("section 1202 gain"),[4] the net short-term capital loss for the taxable year, and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than 18 months to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, rather than only to a portion of the depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 applies shall not exceed the net section 1231 gain for the year.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 15-percent rate is taxed at the 15-percent rate.

For taxable years beginning after December 31, 2000, any gain from the sale or exchange of property held more than five years which would otherwise be taxed at the 10-percent rate will instead be taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which begins after December 31, 2000, which would otherwise be taxed at a 20-percent rate will be taxed at an 18-percent rate. A taxpayer holding a capital asset or property used in the trade or business on January 1, 2001, may elect to treat the asset as having been sold on that date for an amount equal to its fair market value, and having been reacquired for an amount equal to such value.

[4] This results in a maximum effective regular tax rate on qualified gain from small business stock of 14 percent.

B. Legislative History

Reduced tax rate for capital gains

Noncorporate capital gains were taxable at reduced rates from 1921 through 1987. The Revenue Act of 1921 provided for a maximum 12.5 percent tax on gain on property held for profit or investment for more than two years (excluding inventory or property held for personal use). Because of the relatively low tax rates on ordinary income during the 1920s and 1930s, this provision benefited only higher bracket taxpayers.

The system of capital gains taxation in effect prior to the Tax Reform Act of 1986 dated largely from the Revenue Act of 1942 ("1942 Act"). The 1942 Act provided for a 50-percent exclusion for noncorporate capital gains or losses on property held for more than six months. The 1942 Act also included alternative maximum rates on capital gains taxes for noncorporate and corporate taxpayers. The basic structure of the 1942 Act was retained under the Internal Revenue Code of 1954.

The Revenue Act of 1978 increased the exclusion for noncorporate long-term capital gains from 50 to 60 percent and repealed the alternative maximum rate. Together with concurrent changes in the noncorporate minimum tax, this had the effect of reducing the highest effective rate on noncorporate capital gains from approximately 49 percent[5] to 28 percent. The reduction in the maximum individual rate from 70 to 50 percent under the Economic Recovery Tax Act of 1981 reduced the maximum effective capital gains rate from 28 percent to 20 percent.

The Tax Reform Act of 1986 ("1986 Act") repealed the provisions granting reduced rates for capital gains, fully effective beginning in 1988. The 1986 Act provided that the maximum rate on capital gains (i.e., 28 percent) would not be increased in the event the top individual rate was increased by a subsequent public law (unless that law specifically increased the capital gains tax). The Revenue Reconciliation Act of 1990 raised the maximum individual income tax rate to 31 percent, and the Revenue Reconciliation Act of 1993 raised the top income tax rate to 39.6 percent. Neither Act raised the maximum individual capital gains rate.

The current capital gains tax rate structure described in Present Law, above, was enacted by the Taxpayer Relief Act of 1997 (the "1997 Act").

The Internal Revenue Code of 1954 as originally enacted provided for an alternative tax rate of 25 percent on corporate capital gains. The Tax Reform Act of 1969 raised this rate to 30 percent. The Revenue Act of 1978 reduced the corporate alternative rate to 28 percent, and the 1986 Act repealed the corporate alternative rate.

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[5] The 49-percent rate resulted in certain cases where the taxpayer was subject to the individual "add-on" minimum tax and the maximum tax "earned income" limitation.

Holding period

Under the Revenue Act of 1921, the alternative maximum rate for capital gains applied to property held for more than two years. Since that time, Congress has, on several occasions, adjusted the holding period required for reduced capital gains taxation.

The Revenue Act of 1934 provided for exclusion of varying percentages of capital gains and losses depending upon the period for which an asset was held. Under that Act, 20 percent of capital gains was excludible if an asset was held for one to two years, 40 percent if an asset was held for two to five years, and 60 percent if the asset was held for between five and 10 years. Where an asset had been held for more than 10 years, 70 percent of capital gains was excluded.

The Revenue Act of 1938 provided for two classes of long-term capital gains. For assets held for 18 months to two years, a 33-percent exclusion was allowed. Where assets were held for more than two years, a 50-percent exclusion was provided. No exclusion was allowed for assets held for 18 months or less. The 1938 Act also provided alternative ceiling rates applicable to the same holding periods as the capital gains exclusions.

In the 1942 Act, Congress eliminated the intermediate holding period for capital gains purposes. The 1942 Act provided for two categories of capital assets: assets held for more than six months (long-term capital assets), for which a 50-percent exclusion was allowed; and assets held for six months or less (short-term capital assets), for which no exclusion was provided. The alternative tax rates on individual and corporate net capital gains (i.e., the excess of net long-term capital gains over short-term capital losses) were based upon the same six-month holding period.

A six-month holding period for long-term capital gains treatment remained in effect from 1942 through 1976. The Tax Reform Act of 1976 increased the holding period to nine months for 1977 and to one year for 1978 and all subsequent years. The Deficit Reduction Act of 1984 reduced the holding period to six months for property acquired after June 22, 1984, and before 1988. After 1988, the holding period for long-term capital gains has been one year. The 1997 Act provided different rates for long-term capital gains depending on the holding period of the asset. These rates are described above in the Present Law discussion.

Treatment of gain and loss on depreciable assets and land used in trade or business

Depreciable property used in a trade or business was excluded from the definition of a capital asset by the Revenue Act of 1938, principally because of the limitation on deductibility of losses imposed by the Revenue Act of 1934. This step was motivated in part by the desire to remove possible tax deterrents to the replacement of antiquated or obsolete assets such as equipment, where depreciation would be fully deductible against ordinary income if the asset were retained, but loss would be subject to the capital loss limitations if the asset were sold.

The availability of capital gain treatment for gains from sales of depreciable assets stems from the implementation of excess profits taxes during World War II. Many depreciable assets, including manufacturing plants and transportation equipment, had appreciated substantially in value when they became subject to condemnation or requisition for military use. Congress determined that it was unfair to tax the entire appreciation at the high rates applicable to wartime profits. Accordingly, in the Revenue Act of 1942, gains from wartime involuntary conversions were taxed as capital gains. The provision was extended to voluntary dispositions of assets since it was not practical to distinguish condemnations and involuntary dispositions from sales forced upon taxpayers by the implicit threat of condemnation or wartime shortages and restrictions.

The Revenue Act of 1938 did not exclude land used in a trade or business from the capital asset definition. Since basis would have to be allocated between land and other property for purposes of depreciation in any event, the differing treatment of land used in a trade or business and depreciable property used in a trade or business was not viewed as creating serious allocation difficulties.

However, in the Revenue Act of 1942, Congress excluded land used in a trade or business from the definition of a capital asset and extended to such property the same special capital gain/ordinary loss treatment afforded to depreciable trade or business property.

In 1962, Congress required that depreciation on section 1245 property (generally, personal property) be recaptured as ordinary income on the disposition of the property. In 1964, Congress required that a portion of the accelerated depreciation on section 1250 property (generally, real property) be recaptured as ordinary income. Subsequent amendments generally have required that the entire amount of accelerated depreciation on section 1250 property be recaptured as ordinary income. Any depreciation taken to the extent allowable under the straight-line method is generally not recaptured as ordinary income, but rather creates capital gain. The 1997 Act provided that the capital gain attributed to the unrecaptured depreciation is taxed at a maximum rate of 25 percent, rather than at the lower rates applicable to capital gains generally.

II. DISCUSSION OF ISSUES

Preferential rate for capital gains

Many argue that higher income tax rates discourage sales of assets. Preferential tax rates on capital gains impose a smaller tax on redirecting monies from older investments to projects with better prospects, which contributes to a more efficient allocation of capital. A second argument for preferential capital gains tax rates is that they encourage investors to buy corporate stock, and especially encourage investors to provide venture capital for new companies, thereby stimulating investment in productive business activities. Others argue that the capital gains preference may be an inefficient mechanism to promote the desired capital formation. They argue that a preferential capital gains tax rate, broadly applied, is not targeted toward any particular type of equity investment.

The United States has a relatively low rate of household saving, currently less than 5 percent of disposable income. By reducing the tax on realized capital gains, the after-tax return to household saving is increased. Economic evidence is ambiguous on whether, and in what magnitude, household saving responds to changes in the after-tax rate of return.

Proponents of a further reduction in capital gain tax rates observe that many of our major trading partners have lower marginal tax rates on the realization of capital gains than does the United States. Opponents of a capital gains preference argue that the fact that marginal tax rates on capital gains are higher in the United States than in other countries does not imply automatically that American firms are at a competitive disadvantage.

Preferential capital gains treatment on a disposition of corporate stock might be viewed as ameliorating the double taxation of corporate earnings. The first step of double taxation occurs at the corporate level; the second step occurs at the shareholder level as dividends are paid or as shares that have increased in value (presumably by retained earnings) are sold. However, any relief that a capital gains preference provides from the burden of double taxation applies only to retained corporate earnings. Distributed earnings still would be generally subject to double taxation.

Opponents of a further reduction in the rate of tax on capital gains argue that appreciating assets already enjoy a preferential rate of tax and a tax benefit from the deferral of tax on accrued appreciation until the asset is sold. The benefit of deferral reduces inflationary effects. Proponents of a further preference for capital gains contend that the benefit of deferral is insufficient to make up for more than very modest inflation. Moreover, they note that not taxing accrued appreciation is an inherent aspect of a realization-based tax system.

To the extent that preferential rates may encourage investments in stock, opponents have argued that the preference tilts investment decisions toward assets that offer a return in the form of asset appreciation rather than current income such as dividends or interest. On the other hand, it is argued that asset neutrality is not an appropriate goal because risky investments that produce a high proportion of their income in the form of capital gains may provide a social benefit not adequately recognized by investors in the marketplace.

Opponents of the preferential capital gains rate contend that it also encourages taxpayers to enter transactions designed to convert ordinary income to capital gains. On the other hand, it is argued that such "conversion" opportunities are simply an additional tax incentive for types of investments the capital gains preference is intended to encourage.

Holding period for preferential taxation

Present law provides different tax rates applicable to income from the realization of capital gains depending upon the type of asset (e.g., shares of stock in a corporation versus certain depreciable real estate) and the holding period (e.g., stock held for nine months versus stock held for nine years). These different tax rates add complexity to the Code, complicate financial planning, require more detailed record keeping by the taxpayer, require more difficult forms to complete when computing tax liability, and increase the likelihood of inadvertent error. Elimination of one or more of these different rates would reduce complexity.

Tax rates that decrease with the length of the holding period may distort taxpayers' choices regarding the optimal time to make sales and redeploy their investment funds to achieve an efficient mix of expected return and risk. Proponents of tax rates that vary by length of the taxpayer's holding period argue that it is important to encourage long-term investment. They argue that longer holding periods, which effectively lock investors into their investments for periods longer than they might choose in the absence of taxation, promote a more long-run view by the managers of corporations. They contend that because of short-term trading, the stock market forces corporate managers to pursue short-term profits and that short-term profits may come at the expense of funding research and development or other long-term investments. They argue that if corporate management took a longer run view, then different, more productive, investments would be chosen and the nation's economic growth would accelerate.

Opponents of capital gains tax rates that vary by holding period note that there is no economic reason why the holding period of investors should affect the planning horizon of corporate managers as long as all shareholders desire to see the value of their holdings maximized. Opponents further observe that there is little or no empirical evidence that companies in which the turnover rate of the company's shares is high engage in investment strategies different from those of companies in which the turnover rate of the company's shares is low. They cite the high values placed on certain technology stocks as evidence that the stock market is willing to pay for returns which accrue in the future. In addition, the step-up in an asset's basis upon the taxpayer's death provides a significant incentive for long-term holding. Further, opponents point out that tax rates that vary by holding period affect only domestic taxpayers and that tax-exempt organizations (e.g., pension funds) and foreign investors account for a substantial amount of trading volume. By locking taxpayers into their present investments as market opportunities change, the efficiency of capital markets may be reduced, thereby reducing potential gains in aggregate economic growth.

Other proponents of multiple capital gains tax rates argue that reducing rates on assets that have been held for longer periods may provide some rough offset for the effect of inflation on the value of the assets. Opponents note that such offset is quite rough and may not account for the fact that taxation upon realization already provides an effective reduction in the tax burden.

Once a regime of differential rates by holding period has been chosen, the cutoff lengths of the holding period are somewhat arbitrary. Economic analysis can provide little rationale for favoring a distinction between a short-term gain taxed at ordinary income tax rates and a longer held gain which receives some sort of preferential rate. At different times during the past 25 years, the Congress has made this distinction six months, nine months, one year, and, most recently, 18 months.

Distributional effects of a reduction in the taxation of capital gains

A further exclusion from income for gain on the sale of capital assets will benefit directly those taxpayers who hold assets with accrued capital gains. Information is somewhat scant regarding the distribution of assets with accrued capital gains among different taxpayers. Tax return data contain information on which taxpayers have realized capital gains in the past. These data reveal that many taxpayers realize a capital gain from time to time, but the majority of the dollar value of gains realized are by taxpayers who frequently realize capital gains. The largest share of the dollar value of gains realized by those taxpayers who frequently realize capital gains is by higher income taxpayers. As a result, it is higher-income taxpayers who have the greatest tax liability from the realization of capital gains.

Complexity of IRS tax forms

Unlike prior law, the capital gains reduction enacted by the 1997 Act is a multiple rate system: 28 percent for the sum of gain from collectibles, includible small business gain,[6] gain properly taken into account before May 7, 1997, and gain from assets held between 12 and 18 months; 25 percent for unrecaptured real estate depreciation; and 20 percent (10 percent for gain otherwise taxed at 15 percent) for the remainder of the net capital gain. In addition, in 2001, gain from assets held for more than 5 years will be eligible for an 8-percent rate rather than a 10-percent rate and in 2006 assets held more than 5 years and acquired after 2000 will be eligible for an 18-percent rate rather than a 20-percent rate.

Prior to 1987, individuals were allowed a 60-percent deduction for the net capital gain, a system that resulted in a different maximum effective rate for each tax rate bracket. Under the pre-1986 Act rules, no special tax computation was necessary, because a deduction was allowed in computing taxable income and then the tax was computed using the regular tax rate schedule

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[6] For gain of $10 million or less from a single qualifying small business stock, only 50 percent of the qualifying gain is includible. This creates an effective tax rate equal to 14 percent.

or table. In addition, because the deduction was a single fixed percentage, it was unnecessary to apply differing percentages to different components of the net capital gain. Under this system, individuals in any tax bracket reporting capital gain only from mutual fund distributions could report 40 percent of the gain on Form 1040 and not file a Schedule D (the form to report capital gains).

Under the rules in effect from 1991 through 1996, only individuals in the 31-percent or higher tax brackets were required to make the tax computation on the 13-line worksheet to Schedule D, because individuals with taxable incomes below the 31-percent bracket received no benefit of capital gains. (See Appendix A for a copy of the 1996 schedule D and capital gain worksheet.) Under the 1991-1996 rules, capital gain distributions from mutual funds for individuals in the 15- or 28-percent tax bracket could be reported directly on Form 1040 without filing a Schedule D. In 1994, 5.8 million taxpayers reported capital gain distributions in this way.

Under the rules enacted in the 1997 Act, every individual with a net capital gain (including those whose only capital gain is from mutual fund distributions) needs to complete the 36-line tax computation on Schedule D to receive the benefit of the lower capital gain rate. (See Appendix B for a copy of the 1997 Schedule D.) The multiple rate system adopted by the 1997 Act requires Form 1099s and Schedule Ks received by holders of interests in pass-through entities, such as mutual funds, REITS, partnerships, trusts, estates, and Sub S corporations to report multiple categories of gain so that the investor may properly compute the capital gains tax. Additional calculations will have to be added to Schedule D and additional reporting will be required in both 2001 and 2006 when the additional capital gain rates become effective.

Because, under the 1997 Act, amounts taxed at the various rates are based, not on gross gains from within a category, but rather on net amounts of gain, rules for netting gains and losses are needed. The net gain must be arrived at by offsetting gains within a category by losses from within the same category as well as net long-term losses from other categories, net short-term capital losses, long-term capital loss carryovers, and ordinary losses. Also, lower capital gain rates must be computed for income otherwise taxed at the 15-percent rate. The 1997 Act (as proposed to be amended by the Tax Technical Corrections Act of 1997) sets forth rules for making these computations. Many of the additional lines added to the Schedule D for 1997 are needed to do these computations.

Further, section 1231 provides, in general, that if there is a net long-term gain from certain assets used in a trade or business, then all the gains and losses comprising that net gain are capital gains and losses. However, if there is a net section 1231 loss, then all the gains and losses are ordinary gains and losses. When there was only one category of long-term gain and loss, any loss would offset the tax on any gain, dollar-for-dollar, whether or not the gains and losses are all characterized as capital or ordinary. Under the 1997 Act multiple rate system, because section 1231 gains and losses, if treated as long-term capital gains and losses, may fall into differing rate categories, a "notch" may be created where the net amount turns from positive to negative. The 1997 Act dealt with this problem by, in part, limiting 25-percent gain from section 1231 assets to the net section 1231 gain. This too adds additional computational complexity.

Finally, beginning in 1997, any individual having a net capital gain and needing to compute the tentative minimum tax amount is required to fill out a 22-line tax computation on Form 6251 (Alternative Minimum Tax).

If one or more of the categories of capital gain were eliminated, the tax computation could be simplified.[7] However, a rate structure that is different for all taxpayers for income from capital gains as opposed to the rate structure on other income requires all taxpayers with any net capital gain to file a Schedule D, and compute their tax on net capital gain separately from ordinary income. While requiring more taxpayers to undertake more computations and file more forms increases the complexity of the individual income tax, present law reduces the tax burden on income from capital gains compared to prior law.

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[7] After August 13, 1998, gain from certain small business stock will be eligible for a 50-percent exclusion. The includible portion of the gain will be subject to the maximum 28-percent rate and 42 percent of the gain will be a minimum tax preference. This results in a 14-percent maximum regular tax rate (7.5 percent for gain otherwise in the 15-percent bracket) and a 19.88-percent alternative minimum tax rate. The treatment of this gain could be simplified by reducing the exclusion to 30 percent, by treating the includible gain in the same manner as any other capital gain eligible for the 20- and 10-percent maximum rates, and by repealing the minimum tax preference. The maximum regular tax rate would remain 14 percent (7 percent for gain otherwise in the 15-percent bracket) and the alternative minimum tax rate would be 19.5 percent.

APPENDIX A

1996 Schedule D and worksheet to Form 1040

SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service (98)

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

▶ Use lines 20 and 22 for more space to list transactions for lines 1 and 9.

OMB No. 1545-0074

1996

Attachment Sequence No. **12**

Name(s) shown on Form 1040 | **Your social security number**

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-3)		(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
1								
2	Enter your short-term totals, if any, from line 21		2					
3	**Total short-term sales price amounts.** Add column (d) of lines 1 and 2 . . .		3					
4	Short-term gain from Forms 2119 and 6252, and short-term gain or loss from Forms 4684, 6781, and 8824					4		
5	Net short-term gain or loss from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					5		
6	Short-term capital loss carryover. Enter the amount, if any, from line 9 of your 1995 Capital Loss Carryover Worksheet					6		
7	Add lines 1 through 6 in columns (f) and (g)					7	( )	
8	**Net short-term capital gain or (loss).** Combine columns (f) and (g) of line 7 . . . . . . ▶						8	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

	(a)	(b)	(c)	(d)	(e)		(f)	(g)
9								
10	Enter your long-term totals, if any, from line 23		10					
11	**Total long-term sales price amounts.** Add column (d) of lines 9 and 10 . . .		11					
12	Gain from Form 4797; long-term gain from Forms 2119, 2439, and 6252; and long-term gain or loss from Forms 4684, 6781, and 8824					12		
13	Net long-term gain or loss from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					13		
14	Capital gain distributions					14		
15	Long-term capital loss carryover. Enter the amount, if any, from line 14 of your 1995 Capital Loss Carryover Worksheet					15		
16	Add lines 9 through 15 in columns (f) and (g)					16	( )	
17	**Net long-term capital gain or (loss).** Combine columns (f) and (g) of line 16 . . . . . . ▶						17	

Part III Summary of Parts I and II

18	Combine lines 8 and 17. If a loss, go to line 19. If a gain, enter the gain on Form 1040, line 13. **Note:** *If both lines 17 and 18 are gains, see the* ***Capital Gain Tax Worksheet*** *on page 23* . .	18	
19	If line 18 is a loss, enter here and as a (loss) on Form 1040, line 13, the **smaller** of these losses:		
a	The loss on line 18; **or**		
b	($3,000) or, if married filing separately, ($1,500)	19	( )
	Note: *See the* ***Capital Loss Carryover Worksheet*** *on page D-3 if the loss on line 18 exceeds the loss on line 19* ***or*** *if Form 1040, line 35, is a loss.*		

Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side.

Your social security number

Part IV Short-Term Capital Gains and Losses—Assets Held One Year or Less *(Continuation of Part I)*

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-3)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
20						
21 Short-term totals. Add columns (d), (f), and (g) of line 20. Enter here and on line 2 .	21					

Part V Long-Term Capital Gains and Losses—Assets Held More Than One Year *(Continuation of Part II)*

(a)	(b)	(c)	(d)	(e)	(f)	(g)
22						
23 Long-term totals. Add columns (d), (f), and (g) of line 22. Enter here and on line 10 .	23					

Use this worksheet to figure your tax **only** if **(a)** you are filing Schedule D and both lines 17 and 18 of Schedule D are gains, or **(b)** you reported capital gain distributions directly on Form 1040, line 13, **and:**

Your filing status is:	**AND**	**Form 1040, line 37, is over:**	**Your filing status is:**	**AND**	**Form 1040, line 37, is over:**
Single		$58,150	Head of household . . .		$83,050
Married filing jointly or Qualifying widow(er) . .		$96,900	Married filing separately		$48,450

1. Enter the amount from Form 1040, line 37		**1.**	______
2. If you are filing Schedule D, enter the **smaller** of Schedule D, line 17 or line 18. Otherwise, enter the capital gain distributions reported on Form 1040, line 13	**2.** ______		
3. If you are filing Form 4952, enter the amount from Form 4952, line 4e	**3.** ______		
4. Subtract line 3 from line 2. If zero or less, **stop;** you **cannot** use this worksheet to figure your tax. Instead, use the Tax Table or Tax Rate Schedules, whichever applies		**4.**	______
5. Subtract line 4 from line 1		**5.**	______
6. Enter $40,100 ($24,000 if single; $20,050 if married filing separately; $32,150 if head of household)		**6.**	______
7. Enter the **larger** of line 5 or line 6		**7.**	______
8. Subtract line 7 from line 1		**8.**	______
9. Figure the tax on the amount on line 7. Use the Tax Table or Tax Rate Schedules, whichever applies		**9.**	______
10. Multiply line 8 by 28% (.28)		**10.**	______
11. Add lines 9 and 10		**11.**	______
12. Figure the tax on the amount on line 1. Use the Tax Table or Tax Rate Schedules, whichever applies		**12.**	______
13. **Tax.** Enter the **smaller** of line 11 or line 12 here and on Form 1040, line 38		**13.**	______

APPENDIX B

1997 Schedule D to Form 1040

SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

▶ Use Schedule D-1 for more space to list transactions for lines 1 and 8.

OMB No. 1545-0074

1997

Attachment Sequence No. 12

Name(s) shown on Form 1040 | Your social security number

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-4)	(f) GAIN or (LOSS) FOR ENTIRE YEAR. Subtract (e) from (d)
1					
2 Enter your short-term totals, if any, from Schedule D-1, line 2	2				
3 **Total short-term sales price amounts.** Add column (d) of lines 1 and 2 . . .	3				
4 Short-term gain from Forms 2119 and 6252, and short-term gain or (loss) from Forms 4684, 6781, and 8824 . . .				4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . .				5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 9 of your 1996 Capital Loss Carryover Worksheet . . .				6	( )
7 **Net short-term capital gain or (loss).** Combine lines 1 through 6 in column (f) . . . ▶				7	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-4)	(f) GAIN or (LOSS) FOR ENTIRE YEAR. Subtract (e) from (d)	(g) 28% RATE GAIN or (LOSS) * (see instr. below)
8						
9 Enter your long-term totals, if any, from Schedule D-1, line 9	9					
10 **Total long-term sales price amounts.** Add column (d) of lines 8 and 9 . . .	10					
11 Gain from Form 4797, Part I; long-term gain from Forms 2119, 2439, and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824 . .				11		
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . .				12		
13 Capital gain distributions . . .				13		
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 14 of your 1996 Capital Loss Carryover Worksheet . . .				14	( )	( )
15 Combine lines 8 through 14 in column (g) . . .				15		
16 **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f) . . . ▶				16		

*__28% Rate Gain or Loss__ includes all gains and losses in Part II, column (f) from sales, exchanges, or conversions (including installment payments received) **either:** • **Before** May 7, 1997, **or**

• **After** July 28, 1997, for assets held more than 1 year but **not** more than 18 months.

It also includes **ALL** "collectibles gains and losses" (as defined on page D-4).

Part III Summary of Parts I and II

17	Combine lines 7 and 16. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13 **Next:** Complete Form 1040 through line 38. Then, go to **Part IV** to figure your tax if: • Both lines 16 and 17 are gains, **and** • Form 1040, line 38, is more than zero.	17	
18	If line 17 is a loss, enter here and as a (loss) on Form 1040, line 13, the **smaller** of these losses: • The loss on line 17; **or** • ($3,000) or, if married filing separately, ($1,500)	18	( )
	Next: Complete Form 1040 through line 36. Then, complete the **Capital Loss Carryover Worksheet** on page D-4 if: • The loss on line 17 exceeds the loss on line 18, **or** • Form 1040, line 36, is a loss.		

Part IV Tax Computation Using Maximum Capital Gains Rates

19	Enter your taxable income from Form 1040, line 38			19	
20	Enter the **smaller** of line 16 or line 17	20			
21	If you are filing Form 4952, enter the amount from Form 4952, line 4e	21			
22	Subtract line 21 from line 20. If zero or less, enter -0-	22			
23	Combine lines 7 and 15. If zero or less, enter -0-	23			
24	Enter the **smaller** of line 15 or line 23, but not less than zero	24			
25	Enter your unrecaptured section 1250 gain, if any (see page D-4)	25			
26	Add lines 24 and 25	26			
27	Subtract line 26 from line 22. If zero or less, enter -0-			27	
28	Subtract line 27 from line 19. If zero or less, enter -0-			28	
29	Enter the **smaller** of line 19 or $41,200 ($24,650 if single; $20,600 if married filing separately; $33,050 if head of household)			29	
30	Enter the **smaller** of line 28 or line 29			30	
31	Subtract line 22 from line 19. If zero or less, enter -0-			31	
32	Enter the **larger** of line 30 or line 31			32	
33	Figure the tax on the amount on line 32. Use the Tax Table or Tax Rate Schedules, whichever applies ▶			33	
34	Enter the amount from line 29			34	
35	Enter the amount from line 28			35	
36	Subtract line 35 from line 34. If zero or less, enter -0-			36	
37	Multiply line 36 by 10% (.10) ▶			37	
38	Enter the **smaller** of line 19 or line 27			38	
39	Enter the amount from line 36			39	
40	Subtract line 39 from line 38. If zero or less, enter -0-			40	
41	Multiply line 40 by 20% (.20) ▶			41	
42	Enter the **smaller** of line 22 or line 25			42	
43	Add lines 22 and 32	43			
44	Enter the amount from line 19	44			
45	Subtract line 44 from line 43. If zero or less, enter -0-			45	
46	Subtract line 45 from line 42. If zero or less, enter -0-			46	
47	Multiply line 46 by 25% (.25) ▶			47	
48	Enter the amount from line 19			48	
49	Add lines 32, 36, 40, and 46			49	
50	Subtract line 49 from line 48			50	
51	Multiply line 50 by 28% (.28) ▶			51	
52	Add lines 33, 37, 41, 47, and 51			52	
53	Figure the tax on the amount on line 19. Use the Tax Table or Tax Rate Schedules, whichever applies			53	
54	**Tax.** Enter the **smaller** of line 52 or line 53 here and on Form 1040, line 39 ▶			54	